Supreme Court, U.S.
FILED
NOV 10 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-341

In the Supreme Court of the United States

OCTOBER TERM, 1987

WILLIAM E. CAMPBELL, ET UX., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Page

Cases:

Barham v. *United States*, 301 F. Supp. 43 (M.D. Ga. 1969), aff'd, 429 F.2d 40 (5th Cir. 1970) 4
Brannen v. *Commissioner*, 722 F.2d 695 (11th Cir. 1984) 4
Commissioner v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974) 5
Estate of Freeland v. *Commissioner*, 393 F.2d 573 (9th Cir.), cert. denied, 393 U.S. 845 (1968) 4
Goodwin v. *Commissioner*, 75 T.C. 424 (1980), aff'd, 691 F.2d 490 (3d Cir. 1982) 5
Grove v. *Commissioner*, 54 T.C. 799 (1970) 4
Higgins v. *Commissioner*, 312 U.S. 212 (1941) 2
Madison Gas & Electric Co. v. *Commissioner*, 633 F.2d 512 (7th Cir. 1980) 4
Moller v. *United States*, 721 F.2d 810 (Fed. Cir. 1983), cert. denied, 467 U.S. 1251 (1984) 3
Polakof v. *Commissioner*, 820 F.2d 321 (9th Cir. 1987), petition for cert. pending, No. 87-529 4
Pullman-Standard v. *Swint*, 456 U.S. 273 (1982) 6
Tallal v. *Commissioner*, 778 F.2d 275 (5th Cir. 1985) 4
United States v. *Basye*, 410 U.S. 441 (1973) 5

Statutes:

Internal Revenue Code (26 U.S.C.):
§ 162(a) 4
§ 172 2
§ 172(d) 5, 6
§ 172(d)(4) 2
§ 183 4
§ 702(b) 3
§ 1221 4
§ 1221(2) 6

In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-341

WILLIAM E. CAMPBELL, ET UX., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner contends that he is entitled to include in his net operating loss carryback his distributive share of a partnership's losses, even if the partnership itself was not engaged in a trade or business.[1]

1. Petitioner was in the real estate business. A corporation that he owned brokered real estate, and he also acted as a broker individually. He was the sole owner of several parcels of real estate. Pet. App. A1.

In addition, petitioner owned interests in a number of real estate partnerships, each of which, in turn, owned a single parcel of real property. In 1976 and 1977, the partnerships generated losses that were passed through to all

[1] While Gwendolyn E. Campbell is a party hereto by virtue of having joined her husband in the filing of a joint return, William E. Campbell was the principal actor in the transactions at issue. Accordingly, for convenience, we will use the term "petitioner," referring to William E. Campbell.

the partners. Petitioner reported his share of those losses on his income tax returns for 1976 and 1977. Invoking Section 172 of the Internal Revenue Code,[2] petitioner carried back the unused portion of the losses and accordingly received refunds of taxes paid by him for 1973 and 1974. Pet. App. A1, C3.[3]

The Commissioner asserted a deficiency for 1976, and determined a small overpayment for 1977, and disallowed the inclusion of the losses in the net operating loss carryback. The Commissioner's action was based upon his conclusion that the partnerships were not engaged in a trade or business and hence the losses were not incurred in a trade or business as required by Section 172(d)(4) of the Code. Petitioner paid the deficiency for 1976 and sued for a refund of that amount and of the overpayment for 1977. The government counterclaimed for the amounts previously refunded as a result of petitioner's claimed loss carrybacks to 1973 and 1974.

The district court held that petitioner's distributive shares of losses from certain partnerships were eligible for carryback because he had purchased interests in those partnerships for business reasons, namely, as an inducement to prospective partners. The court held that his shares of losses from the remaining partnerships were ineligible for carryback because he had purchased those partnership interests as an investment; investment losses are not treated as losses attributable to a trade or business (see, *e.g.*, *Higgins* v. *Commissioner*, 312 U.S. 212 (1941);

---

[2] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

[3] Section 172 of the Code allows unused net operating loss deductions to be carried back for three years and, if still unused, carried forward for five years. However, in the case of a taxpayer other than a corporation, only business losses may be used to offset business income in computing a net operating loss for a given year and any corollary carryback or carryover to other taxable years. I.R.C. § 172(d)(4).

Moller v. *United States*, 721 F.2d 810, 813 (Fed. Cir. 1983), cert. denied, 467 U.S. 1251 (1984)). Pet. App. A1-A7.

The court of appeals affirmed in part and reversed in part (Pet. App. C1-C6). The court concluded that none of the partnership losses were attributable to a trade or business and therefore that none were eligible for carryback treatment by partners. The court rejected petitioner's contention that the losses must be regarded as business losses simply because petitioner was in the real estate business. Rather, the court held that the nature of a distributive share item is determined at the partnership level, and that nature is then reflected on each partner's return. Thus, if a partnership is not engaged in a trade or business, a partner's share of the partnership's losses cannot be treated as business losses. *Id.* at C4-C5. The court then held that none of the partnerships in question was in a trade or business, noting that each of the partnerships was formed, according to its governing articles, "for investment purposes only." Each partnership held a single parcel of land located in an area of potential urban development, and the annual expenses on the properties in 1976 and 1977 were, on average, 20 times the rental income. Accordingly, the court concluded that the partnerships were "investment vehicles" and were not engaged in a trade or business. *Id.* at C5.

2. Petitioner contends that the character of his share of the partnerships' losses is not governed by whether or not the partnerships were engaged in a "trade or business." This contention was correctly rejected by the court of appeals, and its decision does not conflict with any decision of this Court or of another court of appeals. Accordingly, there is no reason for review by this Court.

The character of items constituting a partner's distributive share is governed by Section 702(b) of the Code, which provides:

> *Character of Items Constituting Distributive Share.* – The character of any item of income, gain,

> loss, deduction, or credit included in a partner's distributive share * * * shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

This language plainly suggests that the partner, in characterizing his distributive share, must look to the partnership entity in order to ascertain the manner in which the item was "incurred by the partnership."

The courts have uniformly recognized this principle. For example, the question whether partnership property is or is not a capital asset as defined in Section 1221 of the Code and, therefore, whether a distributive share of gain from the disposition of the asset must be reported by an individual partner as a capital gain or as ordinary income is resolved at the partnership level (and thus resolved uniformly for all of the partners), not at the level of the individual partner. See *Estate of Freeland* v. *Commissioner*, 393 F.2d 573, 584 (9th Cir.), cert. denied, 393 U.S. 845 (1968); *Grove* v. *Commissioner*, 54 T.C. 799, 804 (1970). And the courts have uniformly held that the existence of a profit motive under Section 183 of the Code likewise must be determined at the partnership level. See *Polakof* v. *Commissioner*, 820 F.2d 321, 323 (9th Cir. 1987), petition for cert. pending, No. 87-529; *Tallal* v. *Commissioner*, 778 F.2d 275 (5th Cir. 1985); *Brannen* v. *Commissioner*, 722 F.2d 695, 703-704 (11th Cir. 1984). Similarly, it is well established that, for purposes of determining whether a partner may take a business expense deduction (I.R.C. § 162(a)) for his share of partnership expenses, the business of the partnership, not of the partner, determines whether the expense was incurred in carrying on a trade or business. *Madison Gas & Electric Co.* v. *Commissioner*, 633 F.2d 512, 517 (7th Cir. 1980); *Barham* v. *United States*, 301 F. Supp. 43, 45 (M.D. Ga. 1969), aff'd, 429 F.2d 40 (5th Cir. 1970); *Goodwin* v. *Commissioner*, 75

T.C. 424, 435-437 (1980), aff'd, 691 F.2d 490 (3d Cir. 1982) (Table).[4]

Petitioner apparently acknowledges the correctness of all of these decisions (see Pet. 7), regarding them as "obvious tenets of partnership tax law" (Pet. 5). He claims, however, that Section 172(d) is different, and therefore he maintains that a partner may carry back his share of partnership losses even if the partnership is not engaged in a trade or business. Petitioner offers no authority to support this proposition, and he does not explain how the statutory language can yield this result while still requiring all other characteristics of various tax items to be determined at the partnership level.

In short, petitioner's argument here is no more than a plea to allow him certain tax advantages that Congress has determined are not available in light of the manner in which he has chosen to structure these particular real estate transactions. This Court has repeatedely noted that, "while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice" (*Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974)). Indeed, acceptance of petitioner's submission could well lead to a windfall for him when he avails himself of the benefits of the limited partnership form of ownership. For example, if one of the parcels of

[4] The general concept that income is ascertained and reported at the partnership level, and retains in the hands of the partners the character so determined, was also recognized by this Court in *United States* v. *Basye*, 410 U.S. 441 (1973). The Court there held that a partnership must report as current income payments made into a retirement trust, since the partnership's right to the payments was noncontingent, even though the right of individual partners to receive payments from the trust was not vested. The partners were therefore required to include in income their distributive share of those payments, even though, as individuals, they had no right currently to receive any part of them. The Court explained that, for this purpose, "the partnership is regarded as an independently recognizable entity apart from the aggregate of its partners" (*id.* at 448).

property involved here had been sold, petitioner could have reported his share of the gain on that sale as a capital gain, because the *partnership* was holding the parcel for investment purposes, not in connection with a trade or business, which would have excepted it from the definition of "capital asset" (I.R.C. § 1221(2)). Yet petitioner insists that he is entitled to carry back his share of the partnership's losses as business losses, on the theory that Section 172(d) alone—and incongruously—requires examination of the "trade or business" question at the *partner* level. The court of appeals correctly rejected this contention.

3. Petitioner's contention (Pet. 8-10) that the court of appeals erred in determining that the partnerships were not engaged in a trade or business is similarly without merit. The record showed that each partnership held a single parcel of land, and each partnership agreement stated that the entity was formed "for investment purposes only." Moreover, the rental for the properties averaged only 1/20th of the annual expenses in 1976 and 1977. Thus, the record plainly showed that the partnerships were not engaged in a rental business designed to make a profit; rather, the properties were simply being held as investments and therefore the partnerships could not generate any business losses. Petitioner points to nothing in the record that casts any doubt on this conclusion. In these circumstances, the court of appeals correctly determined that it need not remand the case to the district court, since "the record permits only one resolution of the factual issue." *Pullman-Standard* v. *Swint*, 456 U.S. 273, 292 (1982).

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FRIED
Solicitor General

NOVEMBER 1987

U.S. GOVERNMENT PRINTING OFFICE: 1987—202-037/60096